

AI, CORPORATE GOVERNANCE AND COMPANY LAW

2023 ANNUAL COMPANY LAW CONFERENCE

22.11.2023



KEY THEMES

- ❑ AI – definition and forms
- ❑ proposed Artificial Intelligence Act
- ❑ Advantages and challenges of AI
- ❑ Recommendations for companies navigating AI



BACKDROP, DEFINITION AND FORMS

- Artificial Intelligence (AI) has been around for many years – e.g. recommending movies on video streaming platforms, influencing the content on social media feeds.
- AI Chatbots (e.g. ChatGPT) – allowing users to ‘communicate’ with them

- **EU’s proposed Artificial Intelligence Act** – classification of AI systems on the basis of the risk they pose to users. Increased or decreased regulation will depend on the risk levels.
- European Parliament’s (EP) **draft definition of an ‘artificial intelligence system’ (AI system)**
“a machine-based system that is designed to operate with varying levels of autonomy and that can, for explicit or implicit objectives, generate outputs such as predictions, recommendations, or decisions, that influence physical or virtual environments”.

- EP’s negotiating position on the proposed Act approved last June. Target for the final vote on the AI Act within the EP in the coming months. Once adopted, the AI Act will be directly applicable across EU member states.
- Wider backdrop of laws on AI being developed worldwide – increased relevance to consider selected implications from a corporate governance and company law perspective.

AI ACT – RISK CATEGORIES AND GOVERNANCE

- AI Act approach on the **level of risk from AI systems**:
 1. Unacceptable risk (e.g. social scoring – classifying individuals on socio-economic status)
 2. High risk – negatively affecting safety or fundamental rights (e.g. assistance in legal interpretation and application of the law)
 3. Limited risk – includes chatbot systems using generative AI. These should comply with minimal transparency requirements, allowing users to make informed decisions.
 4. Minimal risk – includes applications that are widely available, such as spam filters.

EP's proposed recital 58 a: “**Deployers of high-risk AI systems** ... play a critical role in ensuring that fundamental rights are protected, complementing the obligations of the provider when developing the AI system... **Deployers should identify appropriate governance structures in that specific context of use**, such as **arrangements for human oversight, complaint-handling procedures and redress procedures**, because **choices in the governance structures can be instrumental in mitigating risks to fundamental rights in concrete use-cases**.”

Art. 29(4) – obligation on deployers to monitor the operation of high-risk AI systems. **Where deployers are banks**, the monitoring obligations need to be at least in line with the **rules on internal governance arrangements** set out under Art. 74 of the **Capital Requirements Directive**.

- A report published by the Commission in June 2021 focusing on the relevance and impact of AI on company law and corporate governance had found that in the identified examples of AI tools analysed as part of that study, these always involved a human agent who was ultimately responsible for decisions made, notwithstanding the higher or lower autonomy of AI.

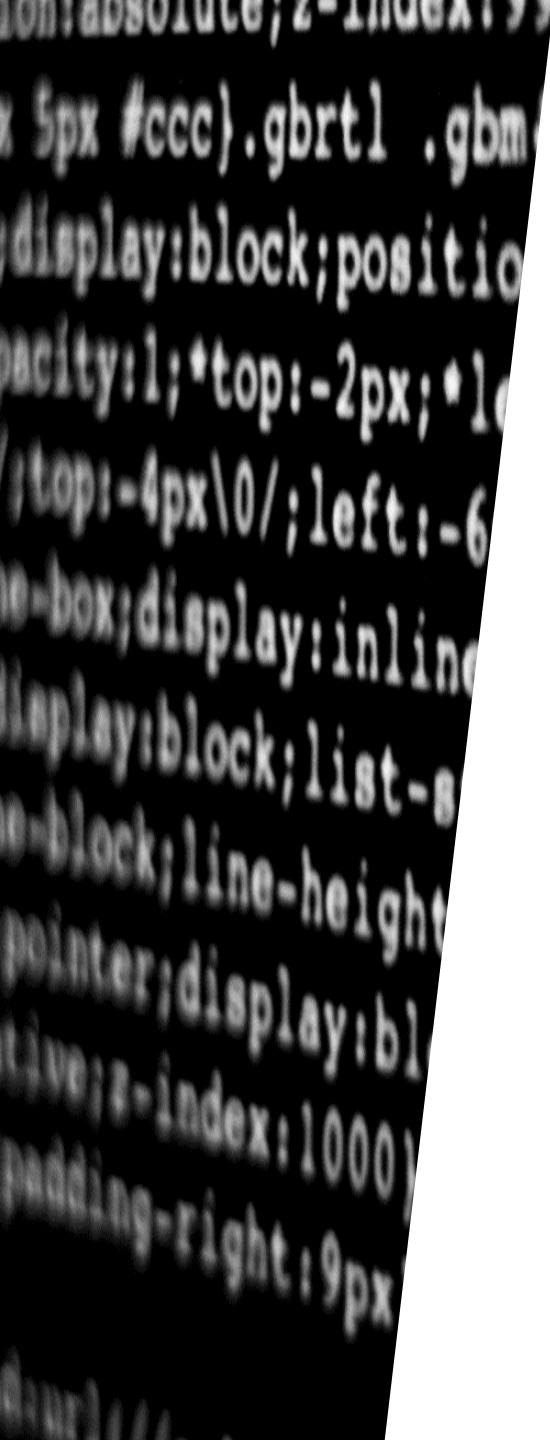
AI Act establishes 6 general principles (proposed Art. 4 a) applicable to all operators developing and using AI systems, which include:

1. 'human agency and oversight' - AI systems shall be developed and used as a tool... that is functioning in a way that can be appropriately controlled and overseen by humans.
2. 'technical robustness and safety' - AI systems shall be developed and used in a way to minimize unintended and unexpected harm, being robust... and being resilient against attempts to alter the use or performance of the AI system so as to allow unlawful use by malicious third parties;

3. 'privacy and data governance' - AI systems shall be developed and used in compliance with existing privacy and data protection rules, while processing data that meets high standards in terms of quality and integrity;
4. 'transparency' - AI systems shall be developed and used in a way that allows appropriate traceability and explainability, while making humans aware that they communicate or interact with an AI system, as well as duly informing users of the capabilities and limitations of that AI system and affected persons about their rights.
5. 'diversity, non-discrimination and fairness'.
6. 'social and environmental well-being'.

THE 2021 COMMISSION REPORT HAD IDENTIFIED A NUMBER OF OPPORTUNITIES AND RISKS ARISING FROM THE USE OF AI IN COMPANY LAW AND CORPORATE GOVERNANCE.

- ❑ Existing/potential opportunities & risks revolving around the boards' decision-making roles
 1. The analytical capabilities of AI systems can help a board in basing its decisions on more data and objective analysis. Mining and quickly processing large amounts of data and track trends could greatly support boards in their business decisions. Directors might benefit from AI support in discharging their duty of loyalty and duty of care to the company.
 2. AI systems can use data analysis capabilities to identify and signal relevant patterns to the company. Boards may also benefit from AI simulation tools that use existing data.

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3. AI may lead to more productive boards, if it allows directors to review and analyse more information than they otherwise would without AI. AI systems could help counter groupthink within the board if it is not adversely influenced by members of the board or any other group: recommendations should be based on the data it collects and analyses.
 4. Potential risks – if a board is supported by AI, analysis behind the AI’s recommendations may not be fully explainable by board members. Would a board be deemed to be compliant with its fiduciary duties if it accept the results from AI without understanding the reasoning and without the opportunity to question the AI solution?
 5. An over-reliance on AI could potentially be seen as a breach of the duty of care. Risk of lack of transparency for shareholders if the role of AI systems used by the directors and how its recommendations are treated are not clearly communicated, documented or monitored.

❑ Other opportunities and risks:

- Challenges may arise with the allocation of liability when an AI technology is involved and there is harm linked to it (e.g. in case of financial losses or reputational damage). The AI solution provider, the training data provider, the actual data providers, or the company operating the system may be all actors with possible responsibility.
 - Commission published a **proposal for a directive on adapting non-contractual civil liability rules to artificial intelligence** (the '**AI liability directive**') in September 2022: this is meant to complement the AI Act. The proposed directive intends to ensure that persons harmed by AI systems enjoy the same level of protection as persons harmed by other technologies in the EU.
 - The AI liability directive would create a rebuttable 'presumption of causality', to ease the burden of proof for victims to establish damage caused by an AI system.
- Legal implication of data loss - legal implications (particularly on liability) from the accidental destruction of company or client data when using AI.

- Data security – Boards should carefully consider possible threats to the security of their data, especially if third country AI providers are involved, with extensive access to company data. Substantial cybersecurity risks may also emerge. AI-driven technologies used in corporate governance and company law with limited human control have been identified as being vulnerable to cybersecurity threats.
- AI systems could support the preparation of financial statements and reports, considerably improving the speed and possibly the quality and depth of reporting. The advantage of AI over existing non-autonomous preprogrammed algorithms may lie in more capacity and flexibility in taking into account more information (from the market or competitors), making informed financial forecasts, and possibly detecting errors, suspicious patterns, or implausible results.
- Checks on legal compliance of financial statements with applicable requirements before their submission could be enhanced.
- Over-reliance on AI may, however, lead a company to take risks that it would not otherwise adopt.

RECOMMENDATIONS FOR COMPANIES NAVIGATING AI

- Mapping their existing and expected development and use of AI.
- Defining their AI strategy and governance.
- Monitoring the key AI regulatory, policy and market developments.
- Assessing the impact of the AI Act and, if active on markets outside the EU, developments in those jurisdictions.
- Different entities will be impacted differently, e.g. banks vs SMEs.
- Depending on the size and nature of the business: assess how existing control frameworks can be enhanced further.
- Assess if the Board / senior management have the required skills and experience.
- If a skills gap has been identified, be one of the first off-the-block to identify and recruit suitable candidates (limited resources with the right level of expertise).



ADDITIONAL INFORMATION

European Parliament Report on the Artificial Intelligence Act -

https://www.europarl.europa.eu/doceo/document/A-9-2023-0188_EN.html#_section1

European Commission, Directorate-General for Justice and Consumers, Study on the relevance and impact of artificial intelligence for company law and corporate governance –

<https://op.europa.eu/en/publication-detail/-/publication/eaf605cd-6181-11ec-9c6c-01aa75ed71a1/language-en>

EP briefing on the Artificial Intelligence Directive -

[https://www.europarl.europa.eu/RegData/etudes/BRIE/2023/739342/EPRS_BRI\(2023\)739342_EN.pdf](https://www.europarl.europa.eu/RegData/etudes/BRIE/2023/739342/EPRS_BRI(2023)739342_EN.pdf)

European Commission, A European approach to artificial intelligence - <https://digital-strategy.ec.europa.eu/en/policies/european-approach-artificial-intelligence>



THANK YOU



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